Forum on democracy & trade

What's TRADE got to do with it? –
Understanding the reach of new international agreements

The whole idea that rules found in international trade agreements could impact local governments seems far-fetched at first. How could an international agreement impact on the traditional powers vested in local governments? How could trade rules limit the scope of citizen input into democra-tic decision-making?

Trade rules are about lowering the barriers for companies trying to sell into foreign markets. Sellers of *goods* have worked for fifty years to lower the tariffs—the at-the-border taxes—that discriminate, on price, against foreign products.

But the latest generation of trade agreements propose much more comprehensive deals. It's not just about selling goods; it's also about selling *services*, and making *investments*. In most communities, the right to provide a service is dependent on the issuing of a permit or license. Foreign investors want assurances that they can get money into a country—and their profits out—with a minimum of red tape.

U.S. investors and local service suppliers understand how democratic traditions inform the way they do business. Rules may change; community values may need to be accommodated. Businesses also rely on the U.S. constitution's 'due process' protections to guard against unlawful seizure of assets. Obviously, businesses also try to make changes in local laws and procedures using the tools of local democracy available to them.

But here's the rub. Multinational sellers of services, and foreign investors, are seeking to change the way that state and local governments do business. They've done so not through the sorts of 'bottom-up,' grassroots efforts at democratic change that characterizes American politics. Instead, they've sought to impose changes 'from above.' And the mechanism for doing so has been through international trade rules, and arguments to the federal government that it should preempt states for the sake of harmonization international standards.

The rules are complex, and drenched in 'legalese.' Rather than pick apart these rules to try to parse out their meaning and applicability, consider instead the following two 'case studies,' modeled on real-life situations.

By following these two 'fact patterns,' it's possible to learn a lot about key provisions in the NAFTA (North American Free Trade Agreement) and the WTO (World Trade Organization) agreement on services.

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CASE #1 –

The water district in a town in New England enters into discussions with a Canadian investor about withdrawing groundwater for use in a bottling plant. The investors present their plans to the state hydrologists, who say, "We'll have to run some tests on flow and recharge rates, but this seems okay to us." The investor gets a business license based on that exchange, and on the investor's submission of initial documents.

(Importantly, the investor documents this conversation with the state hydrologist. Maybe the investor even records it on tape. And puts that documentation in a file.)

Meanwhile, the municipal water district reviews the investor's plan, and decides that it is consistent with the municipality's comprehensive land-use document—that the water withdrawal isn't such a big deal and it should be considered a "low impact business."

But word of the plan gets out, so before the final permitting decisions are made, the water district is confronted with intense public opposition to the idea of the water withdrawal. And so the water district, together with the town planning board, holds a public hearing, hearing testimony from citizens—who, it turns out, are pretty much united in their opposition to the proposed project.

For some people, it's the loss of groundwater that's disturbing. For others, it's the proposed increase in truck traffic on their roads, resulting from the new bottling facility. In any case, it is now clear that the community doesn't consider the proposed water withdrawal to be a 'low impact business,' and so the planning board says, 'whoa, we better look at this.'

Three months later, the project permits are issued. However, the permit only allows for a modest volume of daily water withdrawal; the request to build a new truck-transfer station is denied; and limits on the time, size, and daily number of trucks moving through the town to the water-withdrawal site are imposed. In its decision, the town notes the importance of public input in finding the appropriate 'balance of interests.'

Knowing that U.S. domestic law limits the definition of the 'expropriation' of assets to physical occupation of the property, or the denial of ALL productive uses of the assets, the foreign investor does not challenge the modifications made to the permit, and moves ahead with the project at this smaller scale.

End of story, right? Well, not anymore. In the decade since NAFTA was signed and the WTO was created, there's the possibility that these investors might get a "second bite at the apple."

In this case, the Canadian investor has the option to sue—but not in the U.S. courts, where s/he would surely lose. Instead, as a result of NAFTA investment rules, the investor can file a claim to hear the case before an international investor tribunal. These tribunals are composed of three arbitrators, who themselves are usually commercial lawyers, rather than U.S. judges. The judges don't necessarily have to be American or Canadian citizens, or to have much legal background in the jurisdictions represented in the dispute.

The investor in the first case could claim that the state hydrologists made a promise that the permit would be granted. (Remember that meeting, where the investor took notes, and filed those notes away for possible future use? Did the state hydrologist also keep notes of the conversation? And so when they come before the NAFTA investment tribunal, one party has notes from that day, and the other doesn't—whose version of events can be documented?) The investor also could claim that testimony given at the public hearing was "anti-Canadian" (maybe some of it was); or that the loudest and angriest voices at the public hearing were able to dominate the proceedings—and that all

this resulted in a denial of justice, and a financial loss for the investor. If the arbitrators were to rule for the investors, then the U.S. government would have to pay them for their "lost profits."

The scenario outlined here pulls different 'fact patterns' from actual NAFTA cases. In one notorious dispute, called *Metalclad*, the assurances given to the investor by officials at higher levels of government were taken as a significant factor in ruling *for* the investor, when the town itself wouldn't grant the necessary permits. In many other cases, investors faced with the choice of accepting the compromise given by government officials or resorting to international arbitration have chosen to hold out, to get a second bite at the apple by litigating their claim through an investment tribunal. And finally, in a case still pending that concerns the decision by California to try and prevent open-pit cyanide leach-heap gold mining after a federal permit to dig had been issued (*Glamis*), the Canadian investor actually said in an interview that he was taking his case to a NAFTA investment proceeding because the chance of "success" in that venue was better. He acknowledged that these tribunals represent a more investor-friendly forum for dispute resolution.

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CASE #2 –

A major European property developer and banking consortium, working with a couple of big U.S. retailers as 'anchor tenants', proposes to build a new shopping mall on the outskirts of a [Massachusetts] city. The developer applies for the permits and licenses necessary to break ground on the new project.

The developer gets his permits. But there's a problem. Between the time the developer applied for the permit and its granting, the city changed its definition of what constitutes a 'Big Box' store. It used to be that the city—concerned with revitalizing its downtown, and with reining in 'sprawl'—zoned out any store with floor space greater than 200,000 square feet. Didn't allow them at all. The developer designed the shopping mall with this consideration in mind, and the 'anchor tenants' developed their store plans accordingly.

But the city has drafted new guidelines—maybe in response to this specific development application, maybe not. The city will allow stores with a square footage of between 100,000 and 200,000 square feet, but stores that big have to apply for special permits. Also, they are limited in how much land they can use for parking lots, what kind of lighting they can use, and the store also has to make promises about guaranteeing a certain percentage of managerial and floor jobs to local residents.

The 'anchor tenants' are just not willing to make those changes to the store design, and they pull out of the project. The property developer hasn't broken ground on the project, but all the work to date represents substantial 'sunk costs.' The developer sues the city.

Citing the precedent in the case of Kittery Retail Ventures LLC v. Town of Kittery*—in which the Maine Supreme Court ruled that towns and cities can change their permit-granting criteria even after a development permit is requested, so long as the permit hasn't been granted yet—the court in this case upholds the change in zoning laws.*

The developer is still free to find other tenants that conform to the new city guidelines, and to move ahead with the project accordingly.

This second case is constructed to illustrate something that's at stake in the global trade debate right now. Members of the WTO (including the U.S.) are currently negotiating new rules regarding the *permitted scope of domestic regulation.* Permitted by whom? That is, permitted by WTO rules. Applied to what? Applied to all levels of government. This is an example of a proposed international law that goes far beyond what we usually think of as the purpose of a trade rule—which is to prevent discrimination against foreign businesses. No, in the case of the domestic regulation rules, the WTO *seeks to impose limits on how governments can regulate in the public interest,* and it seeks to impose that limit on *governments at all levels: national, state, city, township, water district*.

Very briefly, the proposed rule that this case illustrates is called "pre-establishment". Proponents of these rules have argued that it should be very, very expensive for governments to change their minds —that is, once they've established the rules, that's it, they shouldn't be allowed to change them during the course of a permitting or registration process. Can't deny the license based on community opposition; can't change regulations while a license is pending; can't impose any new conditions as part of the licensing process; and can't even insert any new requirements at a later time when the license needs to be renewed.

Those rules aren't in place yet. They are still on the table. But the collapse of the 'Doha Round' of international trade negotiations didn't derail this negotiation. In fact, it didn't even really slow it down. Negotiators in the 'Working Party on Domestic Regulation' will return to work later this year to see if they can finalize this set of rules. And there are many voices at the table that are arguing for (among other intrusive rules) the inclusion of this "pre-establishment" test.

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These scenarios illustrate that the WTO and NAFTA go well beyond what most of us consider to be the normal, legitimate scope of a trade agreement—which is to prevent discrimination against foreign commerce. The new global rules instead limit the democratic space available to states, cities, and communities—as well as to national governments, for that matter!

Discussion of the first case focused on NAFTA—the investor was Canadian. Individual investors can bring claims under NAFTA, regardless of whether the Canadian federal government thinks the case has merit or whether it might cause a diplomatic rift between the countries. NAFTA claims can be brought against the United States by *any investor* that has a substantial business presence in Mexico or Canada. That means that under certain circumstances, Wal-Mart Mexico could bring a claim against big-box store rules in New England states. It means *any North American subsidiary of a U.S. corporation* could avail itself of this trade-agreement provision.

The second case looked at a proposed WTO rule. The WTO only allows national governments to raise a claim. WTO cases have usually been filed after diplomacy and bilateral negotiations have failed. But such diplomacy and negotiation of a settlement is frequently accompanied by intense lobbying and pressure brought 'from above.' Two quick examples:

- At the WTO, the European Union and Japan challenged the Massachusetts law that said, "if you do business with the slave-labor regime of Burma, you can't do business with us." The WTO challenge was suspended while a legal case wound its way through the U.S. courts. Eventually, the National Foreign Trade Council, a lobbying operation that acted as plaintiff in the domestic court case, won their case. If Massachusetts had won, there's no doubt that Europe and Japan would have reactivated their WTO challenge.
- The Pharmaceutical Researchers and Manufacturers Association (PhRMA) *lost* three

different cases against state drug-purchasing laws in U.S. federal courts. The same language and arguments used by PhRMA in its unsuccessful bids soon thereafter found its way into U.S. trade negotiating positions. Sure, PhRMA argued that this language was now intended to constrain the drug-purchasing approaches used by U.S. trading partners—rather than to be used against the states. But it took a group of state legislators meeting with U.S. trade negotiators--demanding that an explicit carve-out of that language vis-à-vis the states be included in future trade agreements—to safeguard the rights of states to use preferred drug lists, and to clarify that this PhRMA-crafted language could not be turned against the states in future.

In general, Americans support the international trading system, so long as there's a 'level playing field' with clear rules to the game. Maybe it's time to look anew at the size of the playing field, rather than just whether it tilts this way or that. Maybe some issues are so important to our democracy that they simply don't belong on this negotiated field. Because when trade rules conflict with long-cherished traditions of local control and governance, most Americans would probably choose to safeguard their democracy.

What can State Oversight Commissions on International Trade Do?

International trade commissions set up at the state level can play important roles in raising issues of democracy and local control. How best to respond to international pressures on local decision-making? Among the ideas being discussed:

- State and local governments could do more to ensure that businesses applying for permits and licenses are aware of the rules regarding public hearings, comment periods, and other avenues for citizen input. While this may be 'second nature' to U.S. businesses, new investors in our economy may be less familiar with democratic rights of redress.
- States and cities have considered writing provisions into the permits they issue that would require corporations to waive their use of NAFTA Chapter 11's dispute resolution machinery. Obviously, this doesn't eliminate a company's right of redress; it simply ensures that those grievances are heard by domestic courts, not by NAFTA tribunals.
- Some states, and some of the national associations that represent state and local governments, have already lobbied Congress to call for a revision of existing investment rules, so that foreign corporations enjoy no greater right to compensation than do U.S. investors.
- States and cities are communicating to U.S. trade negotiators about the proposed WTO rules, like pre-establishment discussed above. (Collectively these proposed new rules are called the 'disciplines on domestic regulation.') States and cities have shown instances where citizen input led to modifications of permits and licenses. They wish to ensure that our trade negotiators will not agree to any new 'disciplines' that would prevent local governments from taking decisions based on the balance of input from all parties, including input through citizen petitions, hearings, and other democratic means of expression.
- Members of state oversight commissions can talk to their members of Congress about the proposed WTO rules. Even if the Congress decides that, on balance, a new trade agreement is in the best interests of the United States, right now Congress could make 'reservations' or modifications to any proposed agreement that comes before it for ratification.